1992

Superior Soft Water Company v. Utah State Tax Commission : Brief of Petitioner

Utah Court of Appeals

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IN THE UTAH COURT OF APPEALS

SUPERIOR SOFT WATER COMPANY, Petitioner, vs. UTAH STATE TAX COMMISSION, Respondent.	92-0337-CA Case No. 92_____CA (Supreme Court Case No. 920119)

BRIEF OF PETITIONER

PETITION FOR REVIEW

OF THE FINAL DECISION

OF THE UTAH STATE TAX COMMISSION

ARGUMENT PRIORITY CLASSIFICATION 15

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JURISDICTION

The Supreme Court had jurisdiction in this matter pursuant to Subsection 78-2-2(3)(e)(ii) of the Utah Code, since the matter involves a review a final order in formal adjudicative proceedings originating with the State Tax Commission. The Supreme Court transferred this matter to the Court of Appeals pursuant to Subsection 78-2-2(4) of the Utah Code. The Court of Appeals now has jurisdiction in this matter pursuant to Subsection 78-2a-3(2)(k) of the Utah Code.

Jurisdiction was invoked by means of a Petition for Writ of Review filed in compliance with Rule 14.(a) of the Rules of Appellate Procedure, namely, the Petition for Writ of Review dated March 6, 1992 and filed on Monday March 9, 1992, seeking review of the respondent's Final Decision issued on February 6, 1992.

STATEMENT OF ISSUES AND STANDARD OF REVIEW

This case was initiated by or before the respondent agency before January 1, 1988. Therefore, case law on the standard of review applicable before that date applies to this matter. Morton Int'l, Inc. v. State Tax Comm'n, 814 P.2d 581 (Utah 1991).

1. Was it unreasonable for respondent to require petitioner to collect much more sales tax from a buyer who purchased a water softener after even a minimal period of leasing it than from a buyer who bought it without first leasing it at all? This involves some deference to respondent's expertise in the interpretation of the statutes which respondent is empowered to administer. Id. at 586.

2. Did respondent fail to comply with the Utah Administrative Rulemaking Act in requiring petitioner to remit much more sales tax for each buyer who purchased a water softener after even a minimal period of leasing it than respondent required for a buyer who bought it without first leasing it at all where no rule covering the situation had been promulgated? This is a question of statutory interpretation, with no deference to respondent's expertise. Id. at 585.

3. Was it unreasonable for respondent to require petitioner to remit much more sales tax than petitioner had collected from buyers who each purchased a water softener after even a minimal period of leasing it where in good faith petitioner had collected the same amount of sales tax as respondent's rules required be collected from a buyer who bought a water softener without first leasing it? This involves some deference to respondent's expertise in the interpretation of the statutes which respondent is empowered to administer. Id. at 586.

4. Did respondent violate petitioner's due process rights by requiring petitioner to remit much more sales tax than petitioner had collected from buyers who each purchased a water softener after even a minimal period of leasing it where in good faith petitioner had collected the same amount of sales tax as respondent's rules required be collected from a buyer who bought a water softener without first leasing it? This is a question of constitutional interpretation, with no deference to respondent's expertise. Id. at 585.

STATUTES, ETC., TO BE INTERPRETED

The constitutional provisions, statutes, ordinances, rules, and regulations whose interpretation is determinative consist of the following:

Sales and Use Tax Act, Chapter 12 of Title 59 of the Utah Code, and particularly subsection 59-12-102(13)(b):

> "Tangible personal property" does not include:
> (i) real estate or any interest therin or improvements thereon;
> ...

Rules promulgated in connection with that Chapter including the following:

Rule R865-19-32S:

> A. The lessor shall compute sales or use tax on amounts received or charged pursuant to rental or lease agreements which are made in lieu of outright sales. ...
> B. ... Examples of taxable leases would be neon signs and custom made signs on the premises of the lessee ....

Rule R865-19-51S:

> D. Labor to install tangible personal property to real property is exempt, whether the personal property becomes part of the realty or not. ...
> E. Tangible personal property which is attached to real property, but remains personal property, is subject to sales tax on the retail selling price of the personal property, and installation charges are exempt if separately stated. If the retailer does not segregate the selling price and installation charges, the sales tax applies to the entire sales price, including installation charges.

Rule R865-19-58S:

> A. Sale of tangible personal property to real property contractors and repaimen of real property is generally subject to tax.
> 1. The person who converts the personal property into real property is the consumer of the personal property since he is the last one to own it as personal property.

Rule R865-19-78S:

B. ... Charges for labor to install personal property to realty are not subject to tax . . .

Section 63-46a-3, Utah Code:

(2) In addition to other rulemaking required by law, each agency shall make rules when agency action:

(a) authorizes, requires, or prohibits an action;
(b) provides or prohibits a material benefit;
(c) applies to a class of persons or another agency; and
(d) is explicitly or implicitly authorized by statute.

(3) Rulemaking is also required when an agency issues a written interpretation of a state or federal legal mandate.

Due process clause of the Utah Constitution, Article 1, Section 7:

No person shall be deprived of life, liberty or property, without due process of law.

Due process clause of the United States Constitution, Section 1 of the Fourteenth Amendment:

No state shall ... deprive any person of life, liberty, or property, without due process of law ....

42 U.S.C. Sec. 1983:

Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State or Territory or the District of Columbia, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceedings for redress. ...

42 U.S.C. Sec. 1988:

... In any action or proceeding to enforce a provision of sections 1981, 1982, 1983, 1985, and 1986 of this title, ... the court, in its discretion, may allow the prevailing party, other than the United States, a reasonable attorney's fee as part of the costs.

STATEMENT OF THE CASE

Petitioner had manufactured and then sold and leased water softeners for a period of about 15 years. After about the first 5 years, petitioner learned that it had been collecting too much sales tax. It confirmed with respondent at that time that when a water softener was sold, it became part of the real property. Therefore, petitioner had been the consumer of the materials and a sales or use tax would only apply to the cost of the materials petitioner had used.

After a quitting that business for about 14 years, petitioner resumed its water softener business as before. At that time petitioner contacted respondent to make sure it should continue to collect and remit sales and use taxes as it had done before. However, after a couple of years, respondent audited petitioner for 1985 and 1986, claimed that a deficiency existed for this period, and eventually collected more than $15,000 from petitioner because of additional taxes respondent asserted should have been collected.

Petitioner had employed a marketing strategy of leasing the water softeners, and then after a couple of months, when the advantages of soft water had become evident to the customer, petitioner would often be able to sell the unit. Petitioner had collected and remitted the same amount of tax when a sale resulted during the initial months of a lease as it had for any other sale. Respondent demanded and obtained four or five times as much tax as was collected, claiming that since there had been a period of leasing, a sales tax was owing on the entire sales price, not just

on the cost of the materials.

The facts in more detail are as follows, with citations to the Record from the Agency (R.) and the Transcript of Proceedings (T.):

1. The tax in question is sales tax, and the audit period at issue is January 1, 1985 through December 31, 1986. R. 4.

2. The Petitioner has three different types of transactions with its customers who want a water softener unit. Water softeners are provided on one of the following bases:

(1) The water softener is leased to the customer on a monthly rental agreement, which usually results in a rental period of two to three years. Sales tax is imposed on the monthly lease payment as it is received by the petitioner, and there is no dispute between the parties as to how these transactions are taxed.

(2) The water softener is sold to the customer on a furnish and install contract. On this type of transaction, the petitioner furnishes the materials and supplies, and installs them as a water softener on the premises of the customer. Pursuant to Commission Rule R865-19-58S, the petitioner pays sales and use tax on its cost and materials, i.e., petitioner either pays sales tax to the vendor when materials are purchased, or if the materials are purchased without the payment of sales tax, the petitioner pays use tax when the materials are attached to real property. There is no dispute between the parties as to how these transactions are taxed.

(3) The water softener is leased to the customer

for a period of time, but prior to the expiration of the lease the customer purchases the water softener. In relation to this appeal and pursuant to a special promotion of the petitioner, many purchases were during the first three months of the lease, and customers were given credit against the purchase price for the payments which they had made on the lease. The transactions which are in dispute in this proceeding are those where the purchase occurred during the period of the original lease, regardless of whether the purchase occurred after only three months or after a much longer period of time. R. 48-49.

3. The owners of petitioner were previously in the water softener business from 1956 to 1971 and they re-entered the water softener business in 1985, always doing business as "Superior Soft Water." T. 19-20.

4. From 1956 until 1961 petitioner collected and remitted sales tax on the entire amount of retail sales of water softeners. At that point petitioner learned from a competitor that water softeners were considered to be real property and sales tax should not be collected on the total sales price. Petitioner therefore requested a hearing with the respondent which hearing confirmed that the water softener was considered to be real property and should not be taxed. R. 6, T. 24.

5. Prior to that time, in about 1959 respondent had audited petitioner, but had not informed petitioner that sales tax was being improperly collected. T. 25-26, 47.

6. When petitioner was told at the hearing that taxes

should not have been collected on sales of water softeners, petitioner asked respondent about a refund of the tax improperly collected and remitted. Respondent would only refund the extra tax it had received if the refund was passed on to the purchasers. Petitioner would receive no benefit but would have to provide the labor to find the purchasers and distribute the refunded money. In view of this burden on petitioner, petitioner declined respondent's offer. T. 48-49.

7. Petitioner did not ask respondent if petitioner would have to collect a different amount of sales or use tax when a sale took place prior to the end of a lease, and respondent never suggested it would be treated differently from any other sale. R. 6. An officer of petitioner thought the only issue was whether a water softener was real or personal property. T. 44.

8. Before recommencing operations in 1985, Gerald B. Lambourne, one of the proprietors of petitioner, contacted the respondent by telephone to confirm, for sales and use tax purposes, the correct sales tax treatment of the sale and installation of soft water systems on commercial and residential real property. He was informed that water softeners became part of the real property and were not subject to sales tax, but instead a use tax was imposed on the cost of materials used in the construction of the water softener unit. This advice was consistent with his prior practice and his prior understanding of the law. T. 35-36.

9. In the marketing of water softeners, it was important for the customer to experience the advantages of soft water before

having to commit to a purchase. For that reason, petitioner frequently entered into a lease of a water softener with the expectation of being able to convert the lease to a sale very soon thereafter. T. 41.

10. Had petitioner known it would, upon conversion, have to charge the customer a sales tax on the entire price, it would at least have separated the cost of the water softener from the cost of its installation [to obtain the tax benefit under Part D of Rule R865-19-51S]. T. 40-41.

11. In view of respondent's position that a water softener is real property if sold without having been leased first, and is personal property if first leased for any time at all, petitioner has found it more practical to allow the prospective customer to experience soft water by means of a free trial period rather than by means of a lease. T. 43.

12. During the audit period, one of respondent's auditors purchased a water softener from petitioner after a period of leasing and was not charged sales tax. He may not have read the sales contract, but in any event he did not notify petitioner that petitioner was following an incorrect course of action in failing to charge sales tax. T. 55-65.

13. Also during the audit period, petitioner had no guidance from any rule covering the tax treatment of a sale following some initial period of leasing. T. 34, 64-65, 68-70.

14. The original audit report, dated March 12, 1987, stated that $45,969.40 in tax, $4,596.94 in penalty, and $5,714.33

interest was owing. A subsequent audit adjustment on August 16, 1991 had reduced that amount to $11,855.97 in tax, no penalty, and $2,071.03 in interest. The respondent's Auditing Division applied petitioner's February 16, 1988 payment of $3,000.00 against all of the interest and $928.97 of the tax obligation. Then the interest was updated from February 16, 1988 and that amount was $4,695.32, as of September 15, 1991. (Interest accrued daily at $3.59). Therefore, the respondent's Auditing Division asserted that the total amount owing as of February 15, 1991, was $15,622.32. R. 19-20.

15. Petitioner appealed the assessed amounts and an informal hearing was held on January 6, 1988, David Angerhofer, Hearing Officer, presiding. R. 117.

16. On May 5, 1988, the respondent issued its informal decision in this matter, including the following excerpts:

> Water softeners which are first leased to a customer and then sold to that customer are subject to tax on the monthly rental payments for the duration of the lease, and are subject to sales and use tax on the residual sales price of the later sale of the water softener to that customer.
> ...
>
> Water softeners whch are first leased and then sold to a customer become part of the realty at the time of sale.
>
> The Auditing Division is hereby ordered to adjust its assessment in accordance with this decision. R. 119.

17. On September 16, 1988, petitioner's accountant, Brian C. McGavin, C.P.A., wrote to the respondent on behalf of petitioner requesting a clarification of the respondent's informal decision. R. 113. James E. Harward, Hearing Officer, answered on

January 18, 1989, including the following:

> 3. The sale of a soft water softener unit to a customer after a lease has expired is also a taxable transaction. The price paid, typically the residual value of the water softener at the conclusion of the lease, should have tax computed and charged thereon. R. 112.

18. At some point after January 18, 1989, Gerald Lambourne of petitioner requested clarification of James Harward's January 18, 1989 letter. This was answered by James Harward on April 26, 1989. He first quoted the said paragraph 3, and then stated that:

> [W]hen the water softener is sold and installed by you, you're classified as a real property contractor and the end consumer, therefore, you should be paying use tax on your cost of the water softener because you are installing the water softener on real property. It should be treated the same as an outright sale of the water softener which you install for a customer in real property. R. 111.

19. Respondent's Auditing Division filed a Motion for Reconsideration and Clarification of Informal Decision in this matter on September 22, 1989. R. 94-110.

20. A clarification hearing on the respondent's informal decision was held on February 6, 1991. R. 48.

21. On February 27, 1991, the respondent issued its Order in this matter, clarifying that the decision was meant to uphold completely the assessment of the Auditing Division, but waiving any tax not collected because of a misinterpretation by petitioner of the respondent's decision of May 5, 1988. R. 48-54. A copy of that Order dated February 27, 1991 is attached hereto.

22. A Formal Hearing was then held on this matter on October 29, 1991 before Paul F. Iwasaki, Presiding Officer. R. 4.

23. In a Brief and Memorandum of Points and Authorities submitted before the hearing, as well as in argument at the hearing, petitioner presented arguments showing that there was an unreasonably large additional amount of tax being charged (R. 29, T. 75-76), there had been no pertinent rule promulgated (R. 29, T. 75), it was unreasonable to charge petitioner more than petitioner had collected, since petition had acted in good faith (R. 30-31, T. 77, 82), and it would violate petitioner's constitutional due process rights to charge petitioner more than petitioner had collected (R. 29, T. 77, 83).

24. The respondent's Final Decision of February 6, 1992 affirmed the prior Informal Decision and subsequent Order, noting that since the taxable treatment of the conversion of leases to sales had not come up in discussions between the petitioner and the respondent, petitioner could not have relied upon the respondent's advice to its detriment. R. 8-9.

25. In order for petitioner to avail itself of judicial review of that Final Decision, petitioner had to pay respondent the full amount respondent calculated was owing, pursuant to Section 59-1-505 of the Utah Code.

SUMMARY OF ARGUMENTS

1. It was unreasonable for respondent to require petitioner to collect much more sales tax from a buyer who purchased a water softener after even a minimal period of leasing it than from a buyer who bought it without first leasing it at all. The rules which governed how much sales and use tax was to be paid when a sale

was made in the first instance would also apply in the case of a sale after a period of leasing.

2. Respondent failed to comply with the Utah Administrative Rulemaking Act in requiring petitioner to remit much more sales tax for each buyer who purchased a water softener after even a minimal period of leasing it than respondent required for a buyer who bought it without first leasing it at all where no rule covering the situation had been promulgated. The promulgation of a rule was statutorily required in this case since the agency required an action by the taxpayer, it prohibited a material benefit, and it was an agency interpretation of a state legal mandate.

3. It was unreasonable for respondent to require petitioner to remit much more sales tax than petitioner had collected from buyers who each purchased a water softener after even a minimal period of leasing it where in good faith petitioner had collected the same amount of sales tax as respondent's rules required be collected from a buyer who bought a water softener without first leasing it. Petitioner had collected all of the tax it had been advised to collect after diligent inquiry. It was harsh and unjust to retroactively require petitioner to remit more than it had collected in good faith.

4. Respondent violated petitioner's due process rights by requiring petitioner to remit much more sales tax than petitioner had collected from buyers who each purchased a water softener after even a minimal period of leasing it where in good faith petitioner had collected the same amount of sales tax as respondent's

rules required be collected from a buyer who bought a water softener without first leasing it. The lack of rules and other guidelines left petitioner's duty unconstitutionally vague. In light of this lack of clarity, petitioner was deprived of its property in violation of its due process rights. Petitioner thus has a cause of action under the Civil Rights Act and is entitled to an award of attorney fees thereunder.

ARGUMENT

1. IT WAS UNREASONABLE FOR RESPONDENT TO REQUIRE PETITIONER TO COLLECT MUCH MORE SALES TAX FROM A BUYER WHO PURCHASED A WATER SOFTENER AFTER EVEN A MINIMAL PERIOD OF LEASING IT THAN FROM A BUYER WHO BOUGHT IT WITHOUT FIRST LEASING IT AT ALL.

In a normal sale of a water softener, the difference between the cost of the materials and the total sales price is the amount to install personal property to realty and is not subject to tax. It is only reasonable that this rationale would also apply where the water softener is leased for a period of time before an option to buy the water softener is exercised.

It is acknowledged by both parties that when petitioner sells a water softener and installs it onto the premises, it is not subject to sales tax. Instead, petitioner is required to pay use tax on the materials used in the water softener because petitioner was the consumer of those materials.

Rule R865-19-58S of the Rules of the Commission provides in part A:

> 1. The person who converts the personal property into real property is the consumer of the personal property

since he is the last one to own it as personal property.

In the case of water softeners, petitioner is the last one to own the property as personalty. Therefore petitioner is the consumer of the property and is subject to tax on the cost of the materials. However, petitioner is not subject to tax on the balance of the total sales price, because that represents the charge for labor to install the personal property to the realty, and Rule R865-19-78S provides in part:

> Charges for labor to install personal property to realty are not subject to tax . . .(Emphasis added).

Further, Rule R865-19-51S provides in relevant part:

> D. Labor to install tangible personal property to real property is exempt, whether the personal property becomes part of the realty or not. (Emphasis added).

In this proceeding, the transactions in issue are those in which an option to buy was exercised after beginning the transaction as a lease. Tax was correctly collected and remitted on all lease payments. Petitioner submits that it also correctly paid the tax on the cost of all materials it attached or installed onto real property. Rule 58S makes petitioner the consumer of that property, and petitioner has complied with the rule by paying the tax. Rule 78S provides that "Charges for labor to install personal property to realty are not subject to tax . . ." (Emphasis added). Those charges for labor to install personal property to realty are the only charges on which sales or use tax has not been paid, and the respondent's own Rule 78S says they "are not subject to tax". Rule 51S provides almost exactly the same thing and concludes that labor to install personal property to real property "is exempt".

Thus, the audit assessment by the respondent cannot be sustained without the violation of respondent's own rules. That is not legally permissible so the assessment must be reversed.

2. RESPONDENT FAILED TO COMPLY WITH THE UTAH ADMINISTRATIVE RULEMAKING ACT IN REQUIRING PETITIONER TO REMIT MUCH MORE SALES TAX FOR EACH BUYER WHO PURCHASED A WATER SOFTENER AFTER EVEN A MINIMAL PERIOD OF LEASING IT THAN RESPONDENT REQUIRED FOR A BUYER WHO BOUGHT IT WITHOUT FIRST LEASING IT AT ALL WHERE NO RULE COVERING THE SITUATION HAD BEEN PROMULGATED.

The respondent could not interpret the law as it did without first adopting a new rule.

The respondent has adopted a rule to tax the leases of tangible personal property (Rule R865-19-32S), it has adopted a rule to tax the sale and installation of tangible personal property to real property by contractors such as petitioner (Rule R865-19-58S), and it has adopted a rule to exempt the labor and installation costs to attach tangible personal property to real property (Rules R865-19-51S and R865-19-78S). However, there is no rule anywhere in the rules of the respondent which requires tax to be paid on the total price of the transaction, including the cost of labor to install the tangible personal property to the real property, when a lease is converted to a sales and installation agreement. If the respondent wants to impose tax on those transactions at four or five times the rate of a straight sale, the respondent must first approve that concept and adopt a rule to give notice to all taxpayers of the requirement.

Relevant portions of Section 63-46a-3, Utah Code Annotated, provide:

> (2) In addition to other rulemaking required by law, each agency shall make rules when agency action:
>
> (a) authorizes, requires, or prohibits an action;
> (b) provides or prohibits a material benefit;
> (c) applies to a class of persons or another agency; and
> (d) is explicitly or implicitly authorized by statute.
>
> (3) Rulemaking is also required when an agency issues a written interpretation of a state or federal legal mandate.

In this case, the proposed agency action requires an action by the taxpayer, it prohibits a material benefit, and it is an agency interpretation of a state legal mandate. The agency (Tax Commission) is clearly required to adopt rules prior to taking the proposed action. Without the agency first adopting rules, taxpayers are not given any advance notice of the requirements of the agency. That is precisely the problem in this proceeding. The petitioner called the Tax Commission and was either given some erroneous advice or the policy of the Tax Commission was changed without properly giving notice to the taxpaying public through the rulemaking process. In either event, the problem could have either been prevented or the policy could have been enforced if the respondent had properly adopted a rule. In the absence of such a rule, the respondent's Auditing Division cannot pull such a policy out of the dark closet and impose it on unsuspecting taxpayers. It is a wrong, which so far has improperly cost this taxpayer more than $15,000.00 which it did not collect on the sale of the water softeners.

This rationale was set forth by the Utah Supreme Court in the case of Athay v. State, Dept. of Business Regulation, 626 P.2d 965 (Utah 1981). In that case, the necessity for clear and comprehensive administrative rules was emphasized.

> The legislative grant of authority to the administrative agency is necessarily in general language. It is the responsibility of the administrative body to formulate, publish and make available to concerned persons rules which are sufficiently definite and clear that persons of ordinary intelligence will be able to understand and abide by them. Id. at 968.

An example of where there already existed sufficient clarity, making a rule unnecessary, was found in the case of Plateau Min. v. Utah Div. of State Lands, 802 P.2d 720 (Utah 1990).

In that case, the agency interpreted and enforced a lease provision. The lease had a royalty provision which set forth two different rates, and specified that whichever rate was higher would be the applicable rate.

Certain lessees asked the Court to require the agency to make a rule before collecting the higher rate. The Supreme Court found that there was no need for the promulgation of a rule in order for the agency "to rely on a known lease provision." Id. at 731. As the Court had already found, "The language of the lease provision is clear. The intent of the parties was that the higher of the two rates should be paid the State." Id. at 726.

The facts of the Plateau case certainly contrast with those of the instant matter. There was no clarity at all in any statute, rule, agreement, decision, or oral communication of the respondent regarding the tax to be collected when a lease of a

water softener was converted to a sale. The complete lack of clarity became so apparent that respondent's Auditing Division requested an interpretation of the first effort made by the respondent to address the subject of taxing water softeners purchased after an initial period of leasing. R. 94.

Furthermore, the position of the respondent's auditing division constituted a change in policy which could not be done without first adopting a rule.

Currently, as stated above, there is no rule in the rules of the respondent which impose tax on the full price when a lease transaction is converted to a sale and installation to real property. To now impose tax in that manner constitutes a change of policy by the respondent.

Mr. Lambourne had been in the water softener business with petitioner from the first. When the petitioner recommenced that business, Mr. Lambourne called the respondent and was informed that the sale of water softeners was treated as attachments to real property, which would mean that use tax would be paid on the cost of the materials attached to real property. That representation was the way he had previously paid tax on water softeners, it was the way he understood it had always been done, and it was the way he was now being told to do it in the future.

Then, when the audit was performed by the Auditing Division on petitioner, the policy had changed and petitioner was being hit with at least an $11,000.00 assessment. The respondent had never adopted or even proposed a rule change, and the public

had never been given notice of any such change, but the change in policy was being imposed on petitioner to the tune of over $11,000.00 without any opportunity to first collect the tax from the persons purchasing the water softeners.

Such changes in policy without first going through the rulemaking process is clearly forbidden by the statute cited above. In addition, in Williams v. Public Service Com'n of Utah, 720 P.2d 773 (Utah 1986), the Utah Supreme Court held that an agency of the State of Utah could not change its long-established policy without first following the mandates of the Utah Administrative Rule Making Act. In that case, the Supreme Court said:

> Under all these circumstances, we conclude that the Commission cannot reverse its long-settled position ... and announce a fundamental policy change without following the requirements of the Utah Administrative Rule Making Act. See, e.g., Ford Motor Co. v. FTC, 673 F.2d 1008 (9th Cir. 1981), cert. denied, 459 U.S. 999, 103 S.Ct. 358, 74 L.Ed.2d 394 (1982), see also 2 K. Davis, Administrative Law Treatise Sec. 7:25, at 125 (2d ed. 1978). These requirements were not met. Nonparties were not given notice of the Commission's intention to reconsider its long-held position.... And the November adjudicative hearing certainly cannot be considered an adequate substitute for a rule making proceeding. Many of the protections provided for by the Act were missing from that proceeding, including adequate advance notices to all affected parties, an opportunity to participate, and an opportunity to comment on the proposed rule. U.C.A., 1953, Sec. 63-46a-4 (2d Repl. Vol. 7A, 1978, Supp. 1985). Because the requirements of the Act were not satisfied, the rule is vacated and the matter is remanded for further proceedings. Id. at 777. (Emphasis added).

Consistent with the Williams case, "the Commission cannot reverse its long-settled position and announce a fundamental

policy change without following the requirements of the Utah Administrative Rule Making Act." Taxpayers "were not given notice of the Commission's intention to reconsider its long-held position." The "protection provided for by the Act were missing, including adequate advance notices to all affected parties, an opportunity to participate, and an opportunity to comment."

That is precisely the problem in this proceeding with this petitioner.

3. IT WAS UNREASONABLE FOR RESPONDENT TO REQUIRE PETITIONER TO REMIT MUCH MORE SALES TAX THAN PETITIONER HAD COLLECTED FROM BUYERS WHO EACH PURCHASED A WATER SOFTENER AFTER EVEN A MINIMAL PERIOD OF LEASING IT WHERE IN GOOD FAITH PETITIONER HAD COLLECTED THE SAME AMOUNT OF SALES TAX AS RESPONDENT'S RULES REQUIRED BE COLLECTED FROM A BUYER WHO BOUGHT A WATER SOFTENER WITHOUT FIRST LEASING IT.

In the attached Order dated February 27, 1991, affirmed on page 5 of the Final Decision sought to be reviewed, the respondent affirmed the assessment for taxes for the audit period, 1985 through 1986. R. 8, 52.

The Order then acknowledged on page 5 that petitioner may have in good faith misinterpreted the Informal Decision dated May 5, 1988, and therefore relieved petitioner from paying the taxes it had not collected as a result of its misinterpretation of that Decision. R. 52-53.

However, petitioner had evidenced good faith to at least the same extent before May 5, 1988. It had at one time collected

more than was required by law, collecting and remitting sales tax on the water softeners sold and installed brand new in real property. T. 24. It had been diligent in contacting respondent to make sure that it was collecting the appropriate amount of tax. T. 24, 36.

The only possible accusation against petitioner would be that it did not ask the right question. Its principal did not ask about the situation where a water softener initially leased might be subsequently sold. T. 44.

But why should the burden have been on him, rather than on an auditor or member of respondent, to raise that issue? Why would he be expected to anticipate a possible difference in the tax treatment of a sale depending on whether there had been an initial lease period? The ones he was talking to would have that expertise, not him.

Mr. Lambourne was asked, "[D]id you ever specifically ask any of the people that you've mentioned so far what happens when you first rent and then sell?" T. 44.

In response he stated, "I did not ask that specific question. I asked what a water softener was considered to be, real property or personal property. And I was told that it was real property. There were no stipulations to it. I had no reason to ask any other question than that question. I wanted to know how the Tax Commission looked at a water softener transaction. And that was the question that I asked." Id.

Why should it have occurred to Mr. Lambourne to have asked that other question? If a layman were told that a sale of

his home was a sale of real property for sales tax purposes, would it be expected that he would check again if he rented his home for a while before he sold it?

In view of the fact that good faith existed just as much before May 5, 1988 as after, why was petitioner required to pay from its own pocket those taxes it found out after 1986 that it should have been collecting in 1985 and 1986? If it was inappropriate to give retroactive effect to the February 27, 1991 Order for the period between May 5, 1988 and March 1, 1991 in view of the lack of clarity (R. 52-53), why wasn't it just as harsh and unjust to give retroactive effect to that Order for the period of January 1985-December 1986 in view of the lack of clarity that existed then?

There is a lack of logic and reason to this variant treatment that does not warrant this Court's deference to the Final Decision. That Final Decision was not within the bounds of reasonableness that would prevent the agency's decision from being disturbed. Morton, supra, at 586.

4. RESPONDENT VIOLATED PETITIONER'S DUE PROCESS RIGHTS BY REQUIRING PETITIONER TO REMIT MUCH MORE SALES TAX THAN PETITIONER HAD COLLECTED FROM BUYERS WHO EACH PURCHASED A WATER SOFTENER AFTER EVEN A MINIMAL PERIOD OF LEASING IT WHERE IN GOOD FAITH PETITIONER HAD COLLECTED THE SAME AMOUNT OF SALES TAX AS RESPONDENT'S RULES REQUIRED BE COLLECTED FROM A BUYER WHO BOUGHT A WATER SOFTENER WITHOUT FIRST LEASING IT.

The due process clauses of the Utah Constitution, Article

1, Section 7, and the United States Constitution, Fourteenth Amendment, each provides that Utah shall not deprive any person of property without due process of law.

In the case of Athay v. State, Dept. of Business Regulation, 626 P.2d 965 (Utah 1981), the Utah Supreme Court pointed out that a failure of a State agency to establish guidelines deprived a party to that action of rights of due process of law, citing several federal and state decisions.

As a general rule, if a statute is too vague (and this is not remedied by appropriate administrative rules), then enforcement ignores procedural due process because there is insufficient notice.

> "Vagueness" goes to the issue of procedural due process, i.e., whether the statute is sufficiently explicit and clear to inform the ordinary reader of common intelligence what conduct is prohibited. State v. Hoffman, 733 P.2d 502 (Utah 1987). [Emphasis added.]

If a statute deprives a person of property on the basis of a statute that is not "sufficiently explicit and clear to inform the ordinary reader of common intelligence what conduct is prohibited," then there is a violation of the due process clauses of the Utah and United States constitutions.

> A criminal statute "must be sufficiently clear and definite to inform persons of ordinary intelligence what their conduct must be to conform to its requirements and to advise one accused of violating it what constitutes the offense with which he is charged." [Citations.] A statute that does not meet this test is invalid under both the due process clause of the fourteenth amendment to the federal constitution, [citation], and its counterpart in article I, section 7 of the Utah Constitution. State v. Blowers, 717 P.2d 1321 (Utah 1986). [Emphasis added.]

In the instant matter, there was no statute or rule or anything else that was "sufficiently clear and definite to inform persons of ordinary intelligence what their conduct must be to conform to its requirements" with respect to the collection of sales and use tax on a water softener leased for a few months and then sold. Nevertheless the small business embodied in petitioner has been deprived of over $15,000 of its property. This deprivation has thus been without due process of law.

This deprivation by the respondent, an arm of the State of Utah, of petitioner's due process rights protected by the United States Constitution, acting under the State laws of taxation, constitutes a cause of action under the Civil Rights Act, 42 U.S.C. Sec. 1983. Signore v. City of McKeesport, Pa., 680 F.Supp. 200 (W.D.Pa. 1988).

Even if this Court does not reach the issue of the violation of the United States Constitution, a reversal of the respondent's decision would entitle petitioner to an award of attorneys' fees under 42 U.S.C. Sec. 1988. Lorenc v. Call, 789 P.2d 46 (Utah App. 1990).

In the Lorenc case, an arm of the State of Utah, namely, Granite School District, denied Lorenc fee waivers. She argued that the District policy was more restrictive than the statute, and that the procedures employed violated her due process rights. Lorenc prevailed on the basis of the policy being too restrictive, and the Court of Appeals did not reach the issue of due process. But the appellate court did recognize that the due process claim was

not insubstantial, and hence an award of attorney fees was appropriate.

CONCLUSION

As provided for the rules of the respondent, leases of water softeners are taxable by paying sales tax on the lease payments, and on water softeners that are sold and installed, use tax is paid on the cost of the materials which are installed on the real property. It is unreasonable for respondent to essentially quadruple the sales tax on a sale if a lease is in place for one or two months before the water softener is sold.

The rules of the respondent only cover either a lease or a sale. The respondent has not adopted any rule which requires that tax be paid on the total price of the water softener where an option to buy has been exercised during a lease. Until such a rule is properly promulgated, respondent must not be allowed to enforce that rule.

Since petitioner has been collecting in good faith all of the taxes it should have been, it is unreasonable for respondent to now charge petitioner over $15,000 for taxes it did not collect.

Petitioner's constitutionally protected due process rights have been violated by respondent's deprivation of petitioner's property under color of law.

Based upon each of the foregoing, the petitioner originally properly collected and remitted the correct amount of tax, and this Court should order that the subsequent amount collected by the respondent pursuant to the respondent's Decision and Order of February 6, 1992 be returned, and that Decision and Order be vacated.

Furthermore, petitioner should be awarded its costs including attorney fees herein.

DATED this 28th day of May, 1992.

LYNN P. HEWARD & DELWIN T. POND
Attorneys for Petitioner

By Lynn Heward
LYNN P. HEWARD

MAILING CERTIFICATE

I hereby certify that four copies of this Brief were mailed to Susan L. Barnum, Assistant Attorney General, 36 South State Street, 11th Floor, Salt Lake City, UT 84111 on this 29th day of May, 1992, with postage attached thereon.

Lynn Heward

BEFORE THE UTAH STATE TAX COMMISSION

SUPERIOR SOFT WATER COMPANY	)	
Petitioner,	)	ORDER
v.	)	
AUDITING DIVISION, UTAH STATE TAX COMMISSION	)	Appeal No. 87-1118
Respondent.	)	

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission on February 6, 1991 on a Motion for Reconsideration and Clarification of Informal Decision. G. Blaine Davis, Commissioner, Joe B. Pacheco, Commissioner, and Paul F. Iwasaki, Administrative Law Judge, heard the matter for and in behalf of the Commission. Present and representing the Petitioner was Allen Sims, Attorney at Law. Present and representing Respondent was Susan Barnum, Assistant Attorney General.

The parties had filed briefs and memorandums prior to the hearing. The evidence is contained in the file and the facts are correctly stated in the Informal Decision and are not in dispute. However, the parties have a different interpretation of the effects and the practical application of the Informal Decision of the Commission in this case.

The Petitioner has three different types of transactions with its customers who want a water softener unit. Water Softeners are provided on one of the following bases:

1. The water softener is leased to the customer on a monthly rental agreement, which usually results in a rental period of two to three years. Sales tax is imposed on the monthly lease payment as it is received by the Petitioner, and there is no dispute between the parties as to how these transactions are taxed.

2. The water softener is sold to the customer on a furnish and install contract. On this type of transaction, the Petitioner furnishes the materials and supplies, and installs them as a water softener on the premises of the customer. Pursuant to Commission Rule R865-19-58S, the Petitioner pays sales and use tax on its cost of materials, i.e., Petitioner either pays sales tax to the vendor when materials are purchased, or, if the materials are purchased without the payment of sales tax, the Petitioner pays use tax when the materials are attached to real property. There is no dispute between the parties as to how these transactions are taxed.

3. The water softener is leased to the customer for a period of time, but prior to the expiration of the lease the customer purchases the water softener. In relation to this appeal and pursuant to a special promotion of the Petitioner, many purchases were during the first three months of the lease, and customers were given credit against the purchase price for the payments which they had made on the lease. The transactions which are in dispute in this proceeding are those where the purchase occurred during the period of the original lease, regardless of whether the purchase occurred after only three months or after a

much longer period of time. The parties have a different interpretation of the Order of the Commission, and the Commission has been asked for its interpretation of the Order as it pertains to these transactions.

A portion of the Findings of the Informal Decision relating to these transactions reads as follows:

> "Water softeners which are first leased to a customer and then sold to that customer are subject to tax on the monthly rental payments for the duration of the lease, and are subject to sales and use tax on the residual sales price on the later sale of the water softener to that customer. Separate transactions will have occurred. There is no double taxation."

The Decision and Order of the Informal Decision relating to these transactions reads as follows:

> "Based on the foregoing, it is the Decision and Order of the Utah State Tax Commission that water softeners which are sold outright to the customer and installed become part of the realty. Water softeners which are leased to a customer remain personal property. Water softeners which are first leased and then sold to a customer become part of the realty at the time of the sale.
>
> The Auditing Division is hereby ordered to adjust its assessment in accordance with this decision."

The position of the Petitioner is that the Decision and Order is the language that governs when it states that, "Water softeners which are first leased and then sold to a customer become part of the realty at the time of the sale." The interpretation of the Petitioner is that because it is converted to realty at the time of sale, it should be taxed the same as the sales which are made on a furnish and install contract, i. e., taxes should be

charged only on the cost of materials. They also point out that if their interpretation of the Decision is not correct, then there is no need for the language which orders the Auditing Division to "adjust its assessment in accordance with this decision."

The position of the Respondent is that the wording in the Findings accurately describes how these transactions are to be taxed, when it states they "are subject to sales and use tax on the residual sales price on the later sale of the water softener to that customer. Separate Transactions will have occurred."

Upon a reading of the Informal Decision, it is apparent that the Decision is not clear. It is understandable why the parties do not agree on the interpretation of the Decision and why it requires further interpretation.

The Commission has reviewed the arguments and authorities presented by the parties, and the statutes and rules relating to the sales and use tax. Based on that review, The Commission now makes and enters the following:

ORDER

1. Purchases of water softeners by customers, either during or upon the completion of a lease, are taxable sales by the Petitioner. Thus, for example, if the sale is for $950.00 less three lease payments of $12.95 each, or a total of $38.85, then sales tax must be collected on the purchase price of $911.15 Sales tax would have already been collected on the $38.85 of lease payments. This is what was meant in the Findings of Fact when it stated that such sales after a lease were "subject to sales and use

tax on the residual sales price on the later sale of the water softener to that customer."

2. The above interpretation is also what was intended by the Decision and Order which stated, "Water softeners which are leased to a customer remain personal property. Water softeners which are first leased and then sold to a customer become part of the realty at the time of sale." The interpretation of the Commission of those two sentences is that the water softeners that are leased have not become real property but remain personal property. Because the water softeners were personal property until they were leased, they remain personal property when they are purchased by the customer. Therefore, the full purchase price of the water softeners, less the lease payments where applicable, is subject to sales tax. Only after purchase do the leased water softeners become part of the realty.

3. The original audit assessment determined by the Auditing Division was and is affirmed. The sentence in the original Informal Decision ordering the Auditing Division to adjust its assessment was a standard provision which is placed in most orders. That sentence was not intended to relieve the Petitioner from any responsibility to pay taxes.

4. Because the Petitioner may well have made a good faith misinterpretation of the Informal Decision, there may not have been a collection of tax in accordance with the intent of that Decision. Therefore, if the Petitioner has not collected tax on the full purchase price of the water softeners in accordance with the above

interpretation, the Commission will waive any tax, penalty and interest which Petitioner did not collect between May 5, 1988 and March 1, 1991 which resulted from its misinterpretation of that Decision. This waiver is intended to apply only to the tax, penalty and interest which may have been caused by the lack of clarity of the Informal Decision.

Dated this 27 day of February, 1991.

BY ORDER OF THE UTAH STATE TAX COMMISSION.

R. H. Hansen
Chairman

Roger O. Tew
Commissioner

Joe B. Pacheco
Commissioner

G. Blaine Davis
Commissioner

NOTICE: You have thirty (30) days after the date of the final order to file a request for a Formal Hearing.

STATE TAX COMMISSION SEAL STATE OF UTAH

MAILING CERTIFICATE

I hereby certify that I mailed a copy of the foregoing Order to the following:

Superior Soft Water Company
c/o Gerald B. Lambourne
3575 South West Temple
Salt Lake City, UT 84115

James Rogers
Director, Auditing
Heber M. Wells Bldg.
Salt Lake City, UT 84134

Susan Barnum
Assistant Attorney General
36 South State Street, 11th Floor
Salt Lake City, UT 84111

DATED this 28 day of February, 1991.

Pamela M. Sanford
Secretary

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